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Douglas M. Duncan, County Executive Charles W. Thompson, Jr., County Attorney

Reimbursable Dependent Care Expenses: New IRS Guidelines

Amy Moskowitz

Many employers, including Montgomery County, offer dependent care reimbursement plans as a benefit for their employees. Employees estimate their dependent care expenses for the year, elect to have the amounts deducted from their pay on a pre-tax basis, and then receive non-taxable reimbursements as they incur expenses. Dependent care expenses are incurred by an employee for the care of certain dependents while the employee is working. Deductions are limited to $5,000 for married taxpayers and $2,500 for single taxpayers or married taxpayers filing separately. The IRS recently issued proposed regulations, which include guidance on issues that have arisen since regulations were originally issued.

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County Prevails on Wireless Tax

Clifford Royalty

On March 16, 2005, a bevy of wireless telephone companies challenged Montgomery County's telephone tax in the Maryland Tax Court. It is not entirely clear why the companies suddenly decided to challenge a tax they have been subject to since 1996; nevertheless, the erstwhile competitors found common cause in challenging the tax. The companies argued before the Tax Court that the telephone tax arises from the sale of wireless service to a customer and that the telephone tax is an illegal sales tax.

On June 29, 2006, the Maryland Tax Court rejected the companies' argument. The Tax Court agreed with Montgomery County that the issue had already been substantially decided in the County's favor by the Maryland Court of Appeals in the case of *Montgomery County v. Soft Drink Association*. The Tax Court found that the telephone tax is not triggered by a sale of wireless telephone services, but rather is imposed on the company for the privilege of furnishing a telephone line in the County. The Tax Court noted that, unlike a true sales tax, the County telephone tax is a flat tax and is not imposed on customers. That the companies choose to collect the tax from their customers is irrelevant to the sales tax analysis. The Tax Court further noted that the companies pay the tax before a sale is consummated and do not identify the telephone tax as a sales tax on their invoices.

The County's victory protects, for the near future, an important source of revenue. T-Mobile has filed a petition for judicial review in the Circuit Court, so stay tuned for the outcome of that proceeding. ❖

T-Mobile USA, Inc., et al. v. Department of Finance for Montgomery County, Maryland Tax Court, 05-MI-00-0100.

Reimbursable Expenses *continued from page 1*

Some of the guidance includes:

- Nursery school and preschool qualify as reimbursable expenses. However, kindergarten and levels above are primarily for education and are not reimbursable expenses.
- Day camp qualifies as reimbursable expenses, even if the camp is a "specialty" camp, such as soccer camp or computer camp. Similar after-school care may also qualify.
- The cost of a caregiver transporting a dependent to and from a program is reimbursable.
- Employment taxes paid on a caregiver's wages are reimbursable.
- Costs of providing room and board for a caregiver (beyond the family's usual household expenses) are reimbursable.
- Required application or agency fees or deposits paid in connection with obtaining a caregiver are reimbursable. However, the expenses do not qualify if the care is not ultimately given by the caregiver.
- Allocation of expenses: Generally, an employee must allocate between employment dependent care expenses and non-employment expenses. However, no allocation is required for part-time employees paying on a weekly or monthly basis. For example, if an employee works three days each week, but pays for care on a weekly basis, the employee does not need to allocate the amount paid for dependent care between the three days worked and the two days not worked. However, if the employee has the option of paying for three days per week, but chooses five days of care, allocation is required.
- Absence from work: If an employee pays for dependent care on a periodic basis and is absent from work for a short, temporary period, the employee does not need to allocate between the period of work and the period of absence. For example, where an employee pays on a monthly basis, a five day vacation qualifies as employment related, but a four month absence for illness does not. ❖

The Tax Man Cometh

Malcolm Spicer

While driving around the Township, the ever-vigilant zoning administrator noticed a reflection from a roof or window of a building where he was sure no permit had been issued. He proceeded to park on the public road and walked up a 1,000 foot driveway, past multiple "No Trespassing" signs, to investigate. He came within 200 feet of a clearly visible house for which no permit had been issued.

The zoning administrator returned several weeks later to post a civil citation on the front door. The unpermitted house was also brought to the attention of the Township's tax assessor, who walked onto the property to take photographs and calculate dimensions by counting the foundation blocks. He came within four to six feet of the house.

Looking for a way to pay his new tax bill, the owner sued the Township, zoning administrator, and tax assessor in federal court, claiming violations of his Fourth Amendment rights to be free from unreasonable searches and seizures.

The Sixth Circuit Court of Appeals upheld the Federal District Court's dismissal of the claims and analyzed each entry onto the property. The Court concluded that the first entry was not a Fourth Amendment search, as the observation occurred in "open fields" in which there is no reasonable expectation of privacy. The existence of the "No Trespassing" signs did not change the open field analysis. The second inspection by the zoning official to post a civil citation on the front door was not a search of any kind and, therefore, not a violation.

The third intrusion by the tax assessor presented a more difficult question, as he had entered the curtilage – the area immediately surrounding the home – that harbors the privacies of life. The Court reviewed numerous state and federal decisions involving similar types of searches and concluded that there was no Fourth Amendment violation, as the naked-eye observations were not made for the purpose of a search and exterior attributes and dimensions of the house were plainly visible and the home was not touched, entered or looked into. While this case arose in Michigan and was decided by the Sixth Circuit, this writer would expect a similar result from the Fourth Circuit, which includes Maryland. ❖

Widgren v. Maple Grove Township, 429 F.3d 575 (2005).

Sexual Harassment: Employer's Potential Liability Mitigated

Bernadette Lamson

On May 6, 2006, the U.S. Court of Appeals for the Fourth Circuit issued an employer-friendly decision in which it discusses an employer's responsibility in responding to sexual harassment complaints and the standards imposed, depending if a co-worker, versus a supervisor, does the harassment. The decision demonstrates that employers must react swiftly to complaints by taking decisive action through investigation and addressing personnel issues/conditions related to the complaint (*i.e.*, an employee's work location, duties, chain of supervision).

Stephanie Howard worked as a secretary for the Navy, where her duties included providing administrative services to 55 employees. One of the 55 employees was Randy McCall. Howard alleges that McCall harassed her from June 1995 to November 1996 by speaking to her in a sexually provocative manner and inappropriately touching her breasts, backside, and face. The employer failed to investigate the allegations or discuss the matter with Howard's supervisors. In November 1996, McCall cornered Howard and placed his hand on her face, neck, and breast. Howard immediately notified a co-worker about the conduct and the co-worker reported it to her supervisors. The employer permanently reassigned McCall to a different location and investigated the allegations.

Title VII recognizes that hostile work environment sexual harassment occurs "when the workplace is permeated with [sex-based] intimidation, ridicule, and insult that is sufficiently severe or pervasive to alter the conditions of the victim's employment and create an abusive working environment." To establish hostile work environment sexual harassment in the Fourth Circuit, the conduct must meet the following four-part test: (1) be unwelcome, (2) be based on the individual's sex, (3) be sufficiently severe or pervasive to alter the conditions of the individual's employment and create an abusive work environment, and (4) be imputable to the victim's employer. The employer conceded that Howard could prove the first three factors. The only question on appeal was whether McCall's behavior can be imputable to the employer.

The Fourth Circuit found that the employer took no tangible employment action against Howard. Moreover, Howard acknowledged that McCall did not possess any power to take tangible employment actions or make any economic decisions affecting her. McCall was one of 55 staff members to whom Howard provided administrative support. The Court concluded that McCall's harassment was not aided by the agency relation and, thus, McCall was not Howard's supervisor for Title VII purposes.

If a co-worker harasses another worker, the employer may be liable only if it knew about the harassment and failed to stop it. Title VII imposes liability on the employer only if it fails to take prompt and adequate action after receiving actual or constructive notice of the conduct. The employee must make an effort to inform the employer that a problem exists. The employer's action is adequate when the employer's response results in the cessation

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Office of the County Attorney – Legal Views
101 Monroe Street, 3rd Floor, Rockville, MD 20850
(240) 777-6700
http://www.montgomerycountymd.gov/govtmpl.asp?url=/content/countyatty/index.asp

Publisher
Charles W. Thompson, Jr., County Attorney

Managing Editor
Janita R. Lillard, Paralegal Specialist

Editorial Staff
Sharon V. Burrell
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Legal Views
Office of the County Attorney
101 Monroe Street, 3rd Floor
Rockville, MD 20850

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of the conduct complained. The Fourth Circuit found that the employer was on notice of a potential hostile work environment and was negligent by not following up.

This case illustrates the importance of proper case management. To avoid mismanagement of sexual harassment claims, employers should require *all* sexual harassment allegations investigated and monitored. An inquiry involving all personnel should be conducted and a plan of action adopted based on the findings.

Many supervisors "freeze" when confronted with sexual harassment issues and don't know how to react. When confronted with a possible sexual harassment claim, Montgomery County instructs supervisors to provide a three-point response to the employee. First, supervisors must confirm that the employee has done the right thing by notifying the supervisor. Second, the supervisor should assure the employee that the County takes his/her claim seriously. Finally, the supervisor should emphasize to the employee that the County is responsible for resolving the problem. ❖

Stephanie Howard v. Donald C. Winter, Secretary of the Navy, 446 F.3d 559 (2006).